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PENSIONS AS WAGES

The growing demand on the part of employees for pensions is really a demand for higher wages, using the expression *wages* in its broad sense, as the return which the employee gets from his labor. A pension is as much a part of an employee's real wages as are conditions of labor, guarantee of steady employment, board and lodging (where these are included), medical attention, half pay in case of sickness, and other features not included in the actual money wages received. Theoretically, the simplest way of dealing with labor would be the payment of a money wage, requiring the employee to provide for the hazards of employment and his old age. While here and there an employee does this, by and large the mass of employees do not.

In order to get a full understanding of old-age and service pensions, they should be considered as a part of the real wages of a workman. There is a tendency to speak of these pensions as being *paid* by the company, or, in cases where the employee contributes a portion, as being *paid* partly by the employer and partly by the employee. In a certain sense, of course, this may be correct, but it leads to confusion. A pension system considered as part of the real wages of an employee is really paid by the employee, not perhaps in money, but in the foregoing of an increase in wages which he might obtain except for the establishment of a pension system.

In thus viewing pensions as part of real wages, I do not wish to overlook the humanitarian motives of the employers in establishing these pension systems. On the other hand, a temperamental treatment of the wage question leads to unsound conclusions. The establishment of pension funds by large employers of laborers proceeds, I believe, not so much from any humanitarian motive (except in so far as that is induced by public opinion) as from a recognition that the establishment of pension funds is profitable in attracting a more desirable class of employees, leading to permanency of service, and therefore increasing the collective efficiency of the employees.

In most of the established private pension systems, one striking fact stands out which is of the utmost importance in the treatment of pensions as a form of wages. This fact is that the employee has no contractual right in the pension fund. As

an example of this, take the provision in the pension plan of the International Harvester Company:

Neither the establishment of this system nor the granting of a pension, nor any other action now or hereafter taken by the pension board or by the officers of the company, shall be held or construed as creating a contract or giving to any officer, agent or employee a right to be retained in the service, or any right to any pension allowance; and the company expressly reserves, unaffected hereby, its right to discharge, without liability, other than for salary or wages due and unpaid, any employee, whenever the interests of the company may, in its judgment, so require.

And the pension plan of the New York Central Lines provides:

Rule No. 9.—No action of the Board of Directors in establishing a system of pensions, and no action by the Board of Pensions in the operation of the Pension Department, shall be construed as giving to any employee of this company a right or claim to any pension allowance.

Now this absence of any contractual right is of vital importance to the employee. He foregoes an increase in his wage for the establishment of a pension, but he gets no right to that pension. There is an absence of what in legal parlance is called "mutuality of consideration." Whether such provisions precluding any contract right would be upheld in the courts is not especially in point in this discussion. In a New York case (*McNevin v. Solway Process Co.*, 32 App. Div. 610; affirmed 166 N. Y. 530), the court held that an employee of a private corporation which established a pension fund to which the employee had not contributed, had no right to the accrued share of his pension on dismissal. The court said: "Under the regulations established, it seems to me that none of the employees has a vested interest in any part of this fund, even though credited upon his pass book, until the gift is completed by actual payment. Until that time it is an inchoate gift." It might be well, however, to suggest that lack of consideration has always given the equity side of the courts opportunity to step in. It is not improbable that if the matter were ever brought into the courts elsewhere, this particular part of the plan might be set aside on this ground as well as on the ground of being against public policy. Whatever the legal results may be, the intent on the part of the employer is perfectly clear. From the point of view of the employee the attractiveness of a pension plan consists

in the provision which is made for his old age. With the assurance of provision for his old age, he may adopt a higher standard of living; he may spend what otherwise, assuming he were prudent and thrifty, would be set aside by him for his old-age provision. If he has no contractual right in the pension, he has no assurance of protection. He may die, he may be dismissed at any time, the business may fail or be discontinued, and all the fancied protection disappear. Under such plans, the employee is staking his old-age provision and that of his family upon the hazards of business and upon life itself.

The average employee who would be likely eventually to receive a pension under the plans in vogue has a family dependent upon his earnings. Yet the savings from his wages which go into the pension fund are forfeited in the case of his death (unless in connection with the pension plan there is a life insurance feature). In other words, the realization of his savings toward his old-age protection is forfeited unless he survives the prescribed period. This is in effect a tontine feature which, under the better insurance laws of this country, has been prohibited.

To illustrate by figures this situation, take the terms of the pension fund of the International Harvester Company. The pension to be paid is, for each year of active service, one per cent of the annual average pay during the ten years preceding retirement, with a maximum pension of \$100 per month, and a minimum pension of \$18 per month. Employees may retire at the age of sixty-five if they have been twenty years or more in the service. Assume, for the purposes of this illustration, an employee entering the employ of the company at the age of twenty-five and retiring at the age of sixty-five after 40 years of service, and that his average annual wage for the last 10 years was \$1,200. He would be entitled to a pension of \$480 a year. The cost of an annuity of \$480 in one of the large insurance companies at the age of sixty-five is \$4,324. To accumulate \$4,324 at 3½ per cent interest, in 40 years, requires an annual payment of \$50.03. The value to this employee, therefore, of the provision for his old age is \$50.03 each year. In other words, to provide a fund for his own old age equal to the promised provision of the company, the employee would have to set aside \$50.03 each year. Of course, this sum would be much less, in case the employee purchased at the age of twenty-five, paying

for same annually, a deferred annuity equal to the amount of his pension with the provision that in case of his death before reaching the prescribed age all his payments should be forfeited. But roughly speaking, this \$50.03 annually represents the value to the *individual* each year, in the way of an increase in wages foregone, of the promised provision for his old age. The forfeiture from the deaths and resignations in a group of employees does not result to the benefit of the individual employee but reduces the cost of the system to the employer. Now take this employee after 20 years of service. By this service he has acquired an accumulative value toward his pension of \$50.03 each year. This amounts, in 20 years, at $3\frac{1}{2}$ per cent, to \$1,463, and this is the value of the wages foregone by the employee. If he leaves the service, or his employer goes out of business, he has nothing to show for these 20 years. He not only loses the accumulated value of his pension, but it is now more difficult for him to provide for himself the same old-age provision. In the remaining 20 years, to accumulate the \$4,324 which will buy him the annuity of \$480, he must pay \$147.78 annually, or \$97.75 a year more than the \$50.03 which he was foregoing each year toward the company's pension.

The development of pension plans along such lines would seem to have certain social and economic results which should be carefully considered by employees and by the public. First, it would lead to a certain stratification of the labor class. An employee who has served 20 years toward a pension is less likely to leave that class of work or to take a chance on bettering his condition, knowing that he forfeits the accrued value of the pension. Second, there is a lack of freedom in his relation with the employer. Where the granting of a pension rests entirely in the good graces of the employer, the employee is loath to jeopardize the provision for his old age by independent action. Third, there will be a natural tendency toward a lower rate of money wages or at best the maintenance of the same level of wages, without response to increased cost of living or desires on the part of the employees as a class.

It seems to me on the whole that most of the pension systems adopted by private employers are merely very shrewd bits of wage bargaining. The absence of any contractual right and the lack of assurance that a pension will be paid upon fulfilling the

conditions, give merely the shadow of provision for old age and not the substance.

Pensions for public employees should be considered from the same fundamental bases as pensions for private employees, and they should no less be considered as part of wages. There are, however, considerations affecting public employment which, although in underlying principles no different from cases of private employees, require a somewhat different development as to method and plan. In the case of a government, the whole people is the real employer. The employees, being part of this collective employer, and having through their votes and influence a considerable power in determining the conditions of employment, the relation between employer and employee is not so distinct as in private employment, nor can the relation be quite so strict. For this reason it is generally recognized as being unwise that government labor should be organized in the same fashion as is private labor. To prevent this, however, it is necessary that the government as an employer should be the first to recognize the legitimate and proper demands and necessities of its employees.

At present there is no general pension system for the mass of employees in the federal, municipal, and state service. Pension systems are confined largely to special classes of employees, such as teachers, policemen, and firemen. They are based, in the case of teachers, on the idea that teachers are not paid very much anyway, and that therefore provision should be made for their old age inasmuch as out of their meager wages they cannot be expected to provide for their old age. In the case of policemen and firemen the pensions are, to a certain extent, based on the risk of life and the hardship of the work. The risk of life, of course, so far as it enters into a pension, has really nothing to do with the old-age pensions, but is an indirect form of employers' liability. In most of the pension plans for public employees, there is no contractual right except as to the obtaining of the pension upon fulfillment of the conditions. Upon death or separation from the service the employee forfeits the accrued value of his pension together with whatever contributions he may have made to the fund.

That there is a growing demand on the part of public employees of all classes for pensions is evident to anyone at all familiar with official life, and the question of meeting this demand will be a prominent one among the administrative problems of

the future. No less than in private employ, this demand represents a desire and in many cases a very grave necessity for higher wages. Public employees as a class feel that they are not being paid sufficiently. In many branches of the federal service, wages are still at the standard of years ago. Few public employees are able or willing to make provision for old age out of their salaries. The result is that most governments have what is in effect a pension system without any resulting benefit. Men are kept in official service long beyond their period of usefulness because it is easy for governmental authorities to gratify private charitable impulses at public expense.

Not only does the government suffer loss through the poor quality of work done by such employees and through their incapacity to do full work, but the deadening effect on the government service through this retention of the superannuated naturally impairs the efficiency and morale of the whole force. Moreover, the lack of opportunity for promotion, resulting from clogging up the higher positions with the superannuated, makes the service unattractive and prevents the government from obtaining as efficient a class of employees as it might otherwise do.

In the federal service the main difficulty in the way of adopting a pension system is the conflict between those who contend that the government should pay the pension and those who contend that the employee should pay the pension, or rather that out of the present wage of the employee he should be required to set aside, under government control, sufficient to provide his own pension. Considering pensions as part of wages, as in private employ, this conflict resolves itself into the question whether the present scale of wages, paid employees in the federal government, is sufficient to justify requiring the employees to set aside out of such wages the savings necessary for their pensions. That this is the question is recognized generally by advocates of the so-called "contributory" plan when they say that where wages are found to be inadequate the remedy is to increase the wage. The difficulty with this is that an increase under such a plan would be apt to take the form of a flat rate of increase applying to classes of salaries or wages generally, and not meeting individual cases. Thus, for an illustration, assume two employees, one thirty-five years old and the other forty-five, each getting a salary of \$1200. Under the contributory plan the employee forty-five years old must contribute more to provide for

his pension than the younger employee, yet any increase that would naturally be made would be to raise the salaries of all \$1200 men.

The very demand for pensions on the part of the government employees indicates that the present salaries are not sufficient, according to the ideas of the employees. The logical way to treat this situation would be for the government to pay the pensions and then adjust the money wages accordingly. To expect the employee to provide for a pension system out of his present scale of wages and then rely upon future increases in wages, is to force the employee into the field of collective bargaining for such increases. This would not necessarily take the form of labor unions, but possibly might resolve itself into a more dangerous method, that of lobbying and attempting to influence the election of representatives. Inasmuch as the government is maintaining a quasi-pension plan which it is highly desirable should be abolished, and inasmuch as the adoption of an intelligent pension plan would benefit the government quite as much as the employee, it would seem only the part of wisdom and decent interest in the welfare of its employees, such as the age demands of the government, for it to take the initiative.

Two things should be insisted upon: the separate treatment of each individual as to his pension and the proper funding, year by year, of a pension fund. Unless pensions are treated individually, there is a tendency to overload the fund for special cases or the fund becomes a general grab-bag. Unless proper provision is made for the funding year by year (so that pensions are not merely paid out as part of current expense), there is no way of finding just what pensions are costing nor of checking up and making adjustment. A pension fund of the government should be conducted with the same precision and fiscal intelligence as are the funds of insurance companies and railroads.

Under a system which, starting on the basis of the present rate of wages, the government should pay in addition to these wages the amount necessary for the pension, there would work out, by and large, a better adjustment of wages than could be expected under the contributory plan. For example, take the same two employees, aged thirty-five and forty-five, each getting a salary of \$1200. The pension contribution by the government in the case of the younger employee would be much less than in the case of the older employee, and when, in the natural progress of service,

the time came around for the older employee to receive an increase in salary, it could be pointed out that he was already receiving an increase in the shape of a pension contribution, and in that way wages of employees could be better adjusted to meet individual cases.

In other words, under the contributory plan the tendency would be to raise the wages by some rule of thumb with not so much reference to any individual case as to specific rates of wages. Under the plan in which the government should contribute the pension in addition to the present rate of wages, through promotion and normal salary increases, there would be a better and more exact opportunity for adjusting the individual case, and in the course of a very few years the general situation would be, one might almost say, automatically adjusted.

Considering pensions as a part of wages, the contributions made each year to the pension fund by the government should be considered, subject to one exception, as deferred wages, payable to the employee upon separation from the service, or to his heirs in case of death. The exception to this general principle should be in the case of the early years of service. A pension is not a mere increase in wages; it is an inducement to continued service. Many persons enter government service as a temporary occupation. The right of the employee, therefore, to the accrued value of his pension should not commence until he has passed what might be called the temporary stage. Roughly speaking this would be five or six years, and the accrued value of the pension returned to him upon separation would commence with the beginning of what might be called the more permanent service.

There are two ideas underlying this return of the accrued value of the pension. First, the natural one following from the consideration of a pension as a form of wages, that the accrued value of the pension is actually earned by the employee and as a matter of morals should be returned to him. Second, and this is particularly important in government pensions, the natural instinct of government authorities would be not to dismiss an employee where such dismissal meant the forfeiture of a considerable money value. This is human and obtains very largely, I imagine, in private employment. It obtains to a much greater extent in public employment where there is no pocket nerve touched by the retention of the inefficient. It would make the dismissal of the inefficient government employee much easier for the removing

authority if the accrued value of the pension fund were given him upon dismissal.

A third idea may be added. To the author's mind the success of democracy depends upon the absence of rigid classes or strata among the people. We do not want to develop an office-holding class, except upon the basis of proven efficiency. We, therefore, should not make it difficult for the employee in the government service to get out of the government service because of the lure of a pension at the end of a stated time, the accrued value of which he forfeits if he leaves. We should not make it difficult for those in authority to remove the inefficient because of the forfeiture of the accrued value of the pension.

Considering pensions as wages, and not mere gratuities, such as might have been given by the Stuarts to their court favorites, it seems that a sound pension plan should be developed on the following principles:

(1) Pay the sums necessary to maintain the pension fund over and above the present scale of wages of its employees.

(2) Treat each employee's pension separately.

(3) Make proper funding provision upon actuarial calculation and set aside year by year the necessary sums.

(4) Give to each employee, upon separation from the service, or, in case of death, to his heirs: (a) the accrued value of his pension, or (b) the commutation of such value in the shape of a smaller annual pension, the accrued value of the pension to be determined from such point in his service as would exclude refund in the case of merely temporary service.

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